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IN THE

Supreme Court of the United States

OCTOBER TERM, 1965

No. 793

JOHN S. FOWLER AND JIMMIE LEA FOWLER, *Petitioners,*

against

UNITED STATES, *Respondent.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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To the Honorable Earl Warren, Chief Justice of the United States and the Honorable Associate Justices of the Supreme Court of the United States:

Petitioners, John S. Fowler and Jimmie Lea Fowler, his wife, pray that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Eighth Circuit entered in the above-entitled case on November 4, 1965.

CITATIONS TO OPINIONS BELOW

The unreported memorandum opinion of the Trial Judge, Honorable J. Smith Henley, United States District Judge for the Eastern District of Arkansas, is printed in Appendix B hereto, infra, p. 1a to p. 16a. The opinion of the Circuit Court of Appeals, printed in Appendix B, infra, p. 16a to p. 39a, has not yet been reported.

JURISDICTION

The jurisdiction of this Court is invoked under 28 U.S.C., § 1254 (1).

QUESTIONS PRESENTED

1. Is an admittedly erroneous net worth computation reflecting an understatement of income for a three-year period adequate proof of the crime of wilfully attempting to avoid and defeat the imposition of income taxes known to be payable?

2. Did the supervision of the trial by the District Court and its review by the Court of Appeals satisfy the safeguards for the petitioners specified by this Court in *Holland* v. *United States,* 348 U.S. 121?

STATUTES INVOLVED

Section 7201 of the Internal Revenue Code of 1954, 26 U.S.C., § 7201, defining the crime of income tax evasion is printed in Appendix A, infra, p. 1a.

STATEMENT

Petitioners, John S. Fowler and Jimmie Lea Fowler, his wife, are residents of North Little Rock, Arkansas (Gov's. Exs. 1 to 7, inclusive). On March 2, 1964, they were indicted under Section 7201 of the Internal Reve-

nue Code of 1954 (Appendix A, infra, p. 1a) for evasion of income taxes for the years 1957 to 1959, inclusive. Pleas of not guilty were entered March 31, 1964. Trial was begun on October 19, 1964, and a jury verdict was returned October 27, 1964, finding both petitioners guilty of evasion for each of the three years. The opinion of the Circuit Court affirming the trial court's decision was filed November 4, 1965 (Appendix B, infra, p. 16a).

1. ERRORS IN THE GOVERNMENT'S NET WORTH ANALYSIS

The Government relied upon the net worth method for reconstructing the petitioners' income during the period 1957 through 1959. (R. 587-588; Gov's. Exs. 43 and 44).

Check Float

The Government's net worth computations incorporated the assumption that the petitioners' end of the year bank balances, per bank records, should not be reconciled for outstanding checks which cleared in the first few days of the next year. (R. 576-578; 605-607). Petitioners introduced 93 such year end checks on three different bank accounts as follows (Def. Ex. 5-A):

	12/31/56	12/31/57	12/31/58	12/31/59
Broadway Motel A/C	316.88 (5 cks.)	2,284.00 (11 cks.)	2,269.21 (17 cks.)	3,176.19 (14 cks.)
Mrs. J. S. Fowler A/C	747.22 (7 cks.)	1,584.81 (6 cks.)	928.57 (10 cks.)	871.54 (13 cks.)
Neon Courts A/C	—	386.89 (3 cks.)	329.22 (3 cks.)	568.68 (4 cks.)
TOTAL	1,064.10	4,255.70	3,527.00	4,615.41

After having his attention called to the error during trial, the Special Agent attempted an analysis of the record and reported that the net result was an increase in the total taxable income for all three years of $177.00. No action was taken to relate the changes by years or to show how the check float would have affected the Government's net worth statement which had been presented to the jury. (R. 606).

Obsolescence

The petitioners' CPA, Pratt, called as a government witness, testified that he had chosen to depreciate assets over a long, useful life using a conservative straight-line method of depreciation. (R. 159; 161; 163; 181). The petitioners presented undisputed proof that their major asset, a motel, was becoming obsolete because of the relocation of arterial highways, and, consequently, had a useful life much shorter than that used by Pratt. In its net worth computation, the Government used Pratt's conservative figures and ignored the proof of obsolescence. (Def's. Exs. 4 and 5, R. 711-712; 714-719-723; 730-733; 737).

Landers' Trust Fund

The Government included in its net worth as a liability for 1958 an item of $1,450 allegedly owed by petitioners to a Bill Landers. Landers had left this sum in cash with the petitioners in 1958. The Government did not show this cash as an asset of the petitioners for 1958, but when it was returned to Landers in 1959, the liability was omitted from the net worth statement, resulting in a net worth increase of $1,450. (R. 405-409; 655-656; 779-781).

Bank Debt

Petitioners obtained an installment loan from a North Little Rock Bank on August 6, 1958, of $4,860.50. The balance due on this debt as of the end of 1958 was $3,847.90 and as of the end of 1959 was $1,417.60. (R. 223; 782). This debt was not reflected as a liability in the Government's net worth analysis. (R. 222-223; 654-782).

Omission of Automobiles

The Government omitted without explanation from the assets column of its net worth computation the petitioners' automobiles. (R. 639-647).

Legal Expense

The petitioners leased a restaurant and grill to Ann Harris in 1958. On November 8, 1958, the petitioner, Mr. Fowler, as a landlord was asked by the tenant to force one of the waitresses, Laverne Smith, to remove herself from the premises. Mrs. Smith sued petitioner, Mr. Fowler, over this incident, alleging assault and claiming damages of $80,000. After a mistrial, the petitioner settled with Mrs. Smith by paying $1,200 and, also, petitioner's attorney was paid $500. The Government erroneously treated these payments as non-deductible personal expenditures in its net worth thereby increasing the petitioners' income by an artificial $1,700. (R. 449-452; 691-692; 697-698; 795-796).

2. FAILURE TO APPLY THE STRICT SAFEGUARDS REQUIRED IN A NET WORTH PROSECUTION

Constitutional Rights

The petitioner, Mr. Fowler, has a third grade education and the petitioner, Mrs. Fowler, has an eighth grade education. (R. 70-71; 530-535; 860). At their first conference with the Special Agent, the petitioners were not represented by counsel. The agent attempted to advise the petitioners of their constitutional rights but he concluded that the petitioner, Mr. Fowler, did not understand what his rights were (R. 529) and observed that the petitioner, Mrs. Fowler, was unresponsive. (R. 531).

Cooperation

The first conference was tape recorded and the petitioners told the agents about their backgrounds, the nature and extent of their business activities, explained their books and records and permitted the agents access to their office safe and safety deposit box. (R. 533-534; 543-544). Thereafter, the petitioners were interviewed nine or ten times, responded to questions presented in letter form and the petitioner, Mrs. Fowler, identified a check spread of 535 checks for the agents. (Gov's. Ex. 29; R. 548-550). The petitioners fully cooperated at all times. (R. 551-552).

Reliance on Others

A daughter-in-law of Mrs. Fowler maintained the petitioners' books and records. She had a tenth grade education and no accounting experience. She was never instructed to falsify the books. (R. 158; 463; 685; 689; 698). The petitioners employed a CPA, Howard Pratt, to prepare their income tax returns for

1954 and continuing through the prosecution years. The petitioner, Mr. Fowler, had no contact with Pratt other than at the time of employment. (R. 158-159; 170; 180-182). Pratt was supplied by the petitioner, Mrs. Fowler, with all of the books and records he requested. Pratt prepared the returns making all judgment decisions as to depreciation, income and expense items and related questions. He was never asked to falsify the returns. (R. 159-161; 163-181).

Lack of Corroboration

The Government prepared and planned its trial presentation on the basis of a net worth analysis to be corroborated by a bank deposit-expenditure approximation. (R. 176; 574). In order to shorten the trial, the Government omitted proof of the bank deposit-expenditure analysis and offered a so-called "source-of-funds analysis" beginning January 1, 1955. (R. 480-483; 552-561). This "source-of-funds analysis" was admittedly erroneous in that it omitted consideration of a tax-free flow of funds occasioned by depreciation or long-term capital gain. (R. 558-560). The analysis was not intended to and did not corroborate the correctness of the opening net worth. (R. 574).

Intrusion by Trial Court

During the conduct of the trial, the District Judge intervened time and again, even without objection on the part of the Government, to question the presentation of proof by the petitioners. (R. 127; 163-164; 174-175; 324-325; 379-380). The Court twice observed, within the hearing of the jury, that the petitioners could not revise the useful life of their depreciable assets. (R. 756-757; 759-760).

3. SUMMARY

All of the foregoing were raised on appeal to the Circuit Court, but were held not to be prejudicial to the petitioners.

REASONS FOR GRANTING THE WRIT

1. The determination by the Court of Appeals that a check float as of the end of each year could be overlooked by the Government without commission of error and a finding that a number of errors in the net worth statement were inconsequential are in conflict on these identical points with the cases of *United States* v. *Vardine*, 2 Cir., 305 F. 2d 60 (Appendix C, infra, p. 41a to 51a) and *Flemister* v. *United States*, 5 Cir., 260 F. 2d 513 (Appendix C, infra, p. 51a to 59a).

2. The presence of a series of errors in the Government's net worth computation, tacitly if not directly admitted by the Court of Appeals, the willingness of the Court of Appeals to infer that petitioners "could certainly plan to evade tax obligations" because of success in business and draw no inference of innocence growing out of undisputed cooperation with agents of the Government, combined to reveal an erosion of supervision by the Court of Appeals contrary to the mandate of *Holland* v. *United States*, 348 U.S. 121.

3. The crucial importance of the case in the administration of criminal and civil tax justice generally is reflected by the trend of cases including *Tomlinson* v. *Lefkowitz*, 5 Cir., 334 F. 2d 262, *cert. denied* 379 U.S. 926, to the effect that conviction of income tax evasion collaterally estops taxpayers from contesting the issue of fraud in a civil tax assessment.

ARGUMENT

1. The Determination by the Court of Appeals That a Check Float as of the End of Each Year Could Be Overlooked by the Government Without Commission of Error and a Finding That a Number of Errors in the Net Worth Statement Were Inconsequential Are in Conflict on These Identical Points With the Cases of United States v. Vardine, 2 Cir. 305 F.2d 60 (Appendix C, Infra, pp. 41a to 51a) and Flemister v. United States, 5 Cir. 260 F.2d 513 (Appendix C, Infra, pp. 51a to 59a).

Parallelling identically the flow of proof in *United States* v. *Vardine, supra,* the Government in the instant case and in that case introduced proof of the petitioner's bank account balances as of the end of each prosecution year (Gov. Exs. 43, 44). The defendants here and in *Vardine* then introduced evidence of checks outstanding as of the end of each year in issue (Defs. Ex. 5-A). There, as here, the trial court left it up to the jury to deduct the outstanding checks in correction of the bank account balances and there, as here, the Government contended that the net effect of these errors was to favor the taxpayers.

The Court of Appeals for the Second Circuit reasoned that when a cash basis taxpayer drew his check without limitation on the payee's ability to cash it immediately, the taxpayer was entitled to a deduction in his bank account balance as a matter of law, and ruled that it was an error for the jury to be allowed to speculate on the question. *United States* v. *Vardine, infra,* p. 41a.

In footnote 2 of the *Fowler* opinion, *infra,* p. 29a, the Court of Appeals for the Eighth Circuit recited the language from *Vardine* expressing this conclusion, but sought to avoid its teaching on this point (although citing *Vardine* with approval earlier in its opinion) by

pointing to an absence of "evidence of when the checks were delivered to the people * * * or to show whether or not the checks went to reduce existing liabilities." The checks here in evidence are dated in one year and bear endorsements in the next to make abundantly clear that they were outstanding as of the end of the years involved. The *Vardine* facts are identical in this regard, and the Second Circuit ruled that checks which are outstanding as of the end of the year, as a matter of law, must be subtracted from the bank account balance reflected in the net worth statement.

This conclusion is disputed by the Court of Appeals for the Eighth Circuit and will obviously remain so until settled by the Supreme Court.

Immediately following this discussion of *Vardine* and the check float, the Court of Appeals for the Eighth Circuit observed that "Even assuming that appellants are correct in all matters relating to the trust fund [Bill Landers' deposit of $1,450], the loan [debt due to the Twin City Bank omitted from the Government's net worth computation, the balance of which was $3,847.90 on December 31, 1958, and $1,417.66 on December 31, 1959], the automobiles [omitted as assets], and the check float, there was no prejudicial error here."

In *Flemister* v. *United States,* 5 Cir., 260 F. 2d 513, *infra,* p. 51a, even the innocent omission of a $3,500 liability alone was deemed "too significant to overlook" and, consequently, was declared by that court to constitute prejudicial error. The rationale of *Flemister* was argued on brief and orally to the Court below. The decision was ignored. *Flemister* and *Fowler* are in clear, direct and substantial conflict on this point.

2. The Presence of a Series of Errors in the Government's Net Worth Computation, Tacitly If Not Directly Admitted by the Court of Appeals, the Willingness of the Court of Appeals to Infer That Petitioners "Could Certainly Plan to Evade Tax Obligations" Because of Success in Business and Draw No Inference of Innocence Growing Out of Undisputed Cooperation With Agents of the Government, Combined to Reveal an Erosion of Supervision by the Court of Appeals Contrary to the Mandate of Holland v. United States, 348 U.S. 121.

Eleven years ago in *Holland* v. *United States,* 348 U.S. 121, 125, and in three companion cases, the Supreme Court granted certiorari for review of "the serious doubts [of the Courts of Appeal] regarding the implications of the net worth method" of approximating income. This method was cautiously endorsed by the Supreme Court by language clearly expressing concern about the use of a weapon "that is itself only an approximation," *id.* 129, and "so fraught with danger for the innocent that the courts must closely scrutinize its use." *Id.* 125.

The court then discussed independently each element of the crime of income tax evasion. It concluded this discussion as follows, *id.* 139: "A final element necessary for conviction is wilfulness. The petitioners contend that wilfulness 'involves a specific intent which must be proven by independent evidence and it cannot be inferred from the mere understatement of income.' This is a fair statement of the rule."

In the instant case, the only proof of wilfulness offered by the Government was an understatement for three successive years as reflected by a net worth statement which the Eighth Circuit says may be assumed to be and is, in fact, erroneous in many significant counts.

Whereas, *Holland* goes on to conclude that although a mere understatement alone is not enough, a "consistent pattern of underreporting large amounts of income, and the failure of petitioners to include all their income in their books and records" would support an inference of wilfulness, the Supreme Court significantly *did not say that an erroneous net worth computation will support an inference of wilfulness.*

In the instant case, the Court of Appeals allowed the Government to make the full circle never anticipated by *Holland.* Ill-trained taxpayers, too ignorant to understand a simple example illustrative of their constitutional rights, are said to be smart enough that "they could certainly plan to evade tax obligations" just because they "were apparently intelligent enough to operate a series of successful businesses."

Further, the trial court was clearly more concerned with screening the flow of proof submitted by the taxpayers in defense against a net worth approximation, than in scrutiny of its use, despite the observation of the Court of Appeals that the judge was acting in a proper supervisory capacity.

Extra-judicial statements of one spouse, Jimmie Lea Fowler, were utilized, by way of illustration, for identification of a spread of 535 checks, many of which were included in the net worth statement as non-deductible personal expenditures. This was contrary to the interest of her husband, John S. Fowler and in conflict with the rule of *Olender* v. *United States,* 9 Cir., 210 F. 2d 795, 800.

Finally, the Court of Appeals and the trial court endorsed a clearly planned streamlining of proof on the part of the Government designed to make an erroneous net worth statement stand out in bold relief

despite the clear teaching of *Smith* v. *United States,* 348 U.S. 147, requiring admissions of the taxpayer to be corroborated. Here no corroboration was attempted, although clearly the opening net worth cash balance of $2,000 was based upon the first interviews with taxpayers at a time when they were without counsel and, admittedly, unable to understand their constitutional rights.

Because we live in an era when our Supreme Court has "decided that the time has come to enforce the higher standards [of criminal justice] that we have long professed," (Dean Erwin Griswold quoted in Time, May 21, 1965, p. 63), illustrated by expressions of concern for the ill advised or unadvised in majority decisions like *Escobedo* v. *Illinois,* 378 U.S. 478, and because here we have a crucial admission by agents of the Government that the petitioners did not understand their rights and that the opening cash position was elicited from them in an atmosphere of compulsory disclosure, we submit that, in combination, these errors and attitudes reflect such a departure from *Holland* and related decisions as to require corrective exercise of this Court's power of supervision.

3. The Crucial Importance of the Case in the Administration of Criminal and Civil Tax Justice Generally Is Reflected by the Trend of Cases Including Tomlinson v. Lefkowitz, 5 Cir., 334 F.2d 262 Cert. Denied 379 U.S. 926, to the Effect That Conviction of Income Tax Evasion Collaterally Estops Taxpayers From Contesting the Issue of Fraud in a Civil Tax Assessment.

Eleven years ago when *Holland* was carefully conceived by the Supreme Court, it seems fair to observe that the rationale of *Tomlinson* v. *Lefkowitz, supra,* was, at the most, only a gleam in the eye of a more zealous tax collector. Now these petitioners confront

the proposition, if the verdicts below are allowed to stand, of being estopped to deny that they are guilty of civil fraud, and thus be denied the protection of the statutes of limitation on assessment, rights of pretrial discovery in the United States District Court and, to some extent, in the Tax Court of the United States, and find themselves confronting a presumptively correct assessment which they must pay in full before they may have their day in district court. *Flora* v. *U. S.*, 362 U.S. 145. Where the agents of the Government are overly zealous and the trial and appellate court are less cautious than anticipated by *Holland,* so that the only weapon used to prove wilfulness is a net worth approximation admittedly conceived and concluded in error, the departure by the lower courts must be arrested by the Supreme Court.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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